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Taxation of noncommercial organizations according to the new Tax Code of the Kyrgyz Republic

Starting on January 1 of 2009, a new Tax Code of the Kyrgyz Republic will enter into force. The new Tax Code makes a number of significant changes to the tax structure, including:

- The number of different types of taxes will decrease from 16 to 8, including combining three indirect taxes--(1) tax on use of automobile roads, (2) allocations to the special fund for prevention and liquidation of emergency situations and (3) tax on rendering chargeable goods and services to individuals-- into a single indirect sales tax on goods and services (ranging from 2% till 4%, depending on various factors),
- Value added tax (VAT) rate will decrease from 20% to 12%,
- A new property tax will be introduced.

In general, the provisions of the new Tax Code significantly decrease the tax burden for all taxpayers, including noncommercial organizations (NCOs). The new Tax Code also makes a number of changes to the regime for NCO taxation. These changes fall into two categories:

- 1) provisions applicable to all NCOs; and
- 2) provisions applicable to those NCOs who qualify as charitable organizations.

The improvements in the tax regime are especially remarkable for charitable organizations and include:

- (1) Exemption of charitable organizations from several taxes (such as income tax on all types of income, including income from economic activity, VAT and sales tax);
- (2) An increase in the amount that may be deducted by businesses as charitable donations from 5 to 10 percent of taxable income;
- (3) Elimination of the certification process currently required in order to qualify as a charitable organization and receive these tax benefits. All organizations meeting the requirements set forth in the new Tax Code and the Law on Philanthropy and Charitable Activity will automatically qualify for the benefits.

The new Tax Code could signify tremendous progress in strengthen sustainability of NCOs, increasing provision of social services by NCOs and facilitating philanthropy. Now, it is critical to educate both NCOs and tax authorities on the new provisions and assist with implementing them

consistently and in a non-restrictive manner. This article provides a brief overview of the important provisions which NCOs and their supporters should know about in order to take advantage of them.

NCO taxation

Income (profit) tax

An NCO is subject to the income tax on legal entities (so-called “profit tax”); however, income from certain sources is exempted from this tax. The new Tax Code preserved pre-existing exemptions from the profit tax for income received by NCOs from *grants, humanitarian assistance, endowments, membership and entrance fees*. However, income from any other source--for instance, from the sale of goods and services, or investment income (including passive investment income)--is subject to the profit tax, the same as any other taxpayer.

Value added tax (VAT)

An NCO has the right to choose whether or not to register as a VAT payer, provided the volume of taxable supplies by the NCO does not exceed the registration threshold on VAT during 12 successive months (today it is 4 mln. Kyrgyz soms). However, if the volume of supplies during the indicated period exceeds the registration threshold on VAT, then the NCO is a VAT payer and obliged to register as VAT payer.

The new Tax Code does not fully exempt NCOs from VAT, but it does prescribe an exemption for certain kinds of activities. For instance, according to article 252 of the new Tax Code “supplies, by noncommercial organization at a price not exceeding the expenses associated with carrying out the given supplies, are exempt from VAT, if these supplies are:

- 1) for social welfare and protection of children or indigent citizens of advanced age; or
- 2) in the sphere of education, medicine, culture and sports”.

Land tax and property tax

The property tax is new and provides for a tax on real estate improvements and motor vehicles. This tax must be distinguished from the land tax, which is carried over without change from the previous Tax Code and applies only to that portion of land without improvements. In compliance with article 343 of the new Tax Code, “lands of organizations of disabled persons, war participants and similar categories of people and lands of communities of the blind and the deaf”, will be exempted from the land tax. Land owned by an NCO that does not qualify for any of these exemptions is subject to the land tax according to the general rule.

An NCO is subject to the new property tax, according to which the value of any real property improvement is taxed at differential rates, depending on the year of construction, type of building materials from which the immovable property is built (bricks, concrete etc.), and the location of the property within the country and municipality (if applicable).

Other taxes

NCOs and their employees remain subject to various other taxes imposed or retained by the new Tax Code according to the standard tax regime. Other than the exemptions set forth above, NCOs not qualifying as charitable organizations remain subject to the profit tax on sources of income and must register as VAT payers if their volume of taxable supplies reaches the registration threshold. Employees of NCOs must pay income tax on their wages. NCOs are not exempt from application of the new sales tax or, as noted above, the new property tax.

Taxation of charitable organizations

The new Tax Code prescribes substantial tax preferences for NCOs that qualify as charitable organizations. A charitable organization is defined as a noncommercial organization that meets the following characteristics:

- a) the organization is organized and carrying out charitable activity in compliance with the legislation of the Kyrgyz Republic on noncommercial organizations and charitable organizations;
- b) the organization does not conduct any activity involving production or sale of excise goods or the gambling industry; and
- c) the organization does not provide support to political parties or to candidates in election campaigns¹.

It is remarkable that the new Tax Code eliminates the procedure required under former law whereby an NCO could qualify for the tax benefits accruing to a charitable organization only after it obtained certification as such by tax authorities. Now, an NCO meeting the qualifications in the new Tax Code and in the Law on Philanthropy and Charitable Activity is automatically entitled to the tax preferences accruing to charitable organizations.

Charitable organizations are exempt from payment of the following taxes:

- (1) profit tax.

In addition to those types of income, which are exempt for all NCOs (grants, humanitarian assistance, endowment, membership and entrance fees), charitable organizations are exempt from the profit tax on any type of income. This includes income received from the sale of goods and services, revenues received from fundraising activities (for instance, by conducting a charitable ball) and non-operational economic activity (for instance, rent payment and investment income)². However, it should be noted that a charitable organization has the right to carry out economic activity only for achievement of goals for which it was created and which correspond to these goals.

- (2) VAT, if supplies are for charitable purposes

The new Tax Code does not explain what is meant by “supplies for charitable purposes”. However, article 1 of the Law “On Philanthropy and Charitable Activity” enumerates goals for which charitable organizations can be created. These goals should be considered an interpretation of “supplies for charitable purposes”, which it is hoped will be clarified in subsequent legal acts developed and adopted for implementation of the new Tax Code.

¹ Part two article 153 of the new Tax Code.

² Article 7 of Law “On Philanthropy and Charitable Activity ”

(3) Sales tax

In addition, the new Tax Code seeks to encourage legal entities and individual entrepreneurs to support charitable organizations, by providing that “money and property, transferred to charitable organizations, as well as organizations of culture and sports, regardless of its form of ownership, during the tax year in an amount not exceeding **10 percent** of the taxable income of the taxpayer, are subject to deduction from total annual income, provided these assets are not used for the benefit of transferring taxpayer.”³ Compared to the old Tax Code, the available deduction amount in the new Tax Code has doubled from 5% to 10%.

Conclusion

The tax regime for NCOs in Kyrgyzstan is still far from ideal and has substantial shortcomings. The new Tax Code fails to provide an income tax deduction for citizens (who are not individual entrepreneurs) to make donations for the benefit of charitable organizations. The new Tax Code also does not provide an exemption from the land tax for charitable organizations, nor does it exempt NCOs from the new property tax, which imposes a significant burden on the shoulders of NCOs and charitable organizations. There is more work to be done to bring the conditions of NCO taxation in Kyrgyzstan closer to international standards.

However, it is important to mention that the new Tax Code establishes a more favorable tax regime for NCOs than the present Tax Code, especially for those NCOs which carry out their activity as charitable organizations. This represents a significant breakthrough which should benefit NCOs working to improve social conditions in Kyrgyzstan.

³ Article 208 of new Tax Code.